STATE OF NORTH DAKOTA

BISMARCK, NORTH DAKOTA

REPORT OF EXAMINATION

OF

HEALTH FACILITIES INSURANCE EXCHANGE

GRAND FORKS, NORTH DAKOTA

AS OF
DECEMBER 31, 1996

STATE OF NORTH DAKOTA

DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that I have compared the annexed copy of the Report of Examination of the

Health Facilities Insurance Exchange

Grand Forks, North Dakota

as of December 31, 1996, with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal at my office in the City of Bismarck, this _____ day of _______________, 1998.

____
Glenn Pomeroy
Commissioner of Insurance

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December 9, 1997
Grand Forks, North Dakota

Honorable Glenn Pomeroy
Commissioner of Insurance
State of North Dakota
600 East Boulevard Avenue
Bismarck, ND 58505

Dear Sir:

Pursuant to your instructions and in accordance with the North Dakota Insurance Code and resolutions adopted by the National Association of Insurance Commissioners ("NAIC"), an examination was made of the condition and affairs of the

Health Facilities Insurance Exchange
Grand Forks, North Dakota

as of December 31, 1996.

SCOPE OF EXAMINATION

This examination was a financial condition examination conducted in accordance with N.D.C.C. § 26.1-09-09 and observed guidelines and procedures contained in the NAIC *Financial Condition Examiners Handbook*. The examination was conducted to determine the Company's financial condition, its compliance with statutes, and to review the corporate affairs and insurance operations. The current examination covers the period January 1, 1991, through December 31, 1996, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

Examination procedures included a verification and evaluation of assets, a determination of liabilities, and review of corporate records, claim files, and other records relating to Company operating practices.

HISTORY

General

Health Facilities Insurance Exchange ("Company") was chartered on December 14, 1990, subject to N.D.C.C. Chapter 26.1-09. The Company is organized as an unincorporated association which is operated as a reciprocal insurance exchange. A reciprocal exchange is a group of persons, firms, or corporations commonly referred to as "subscribers" that exchange reciprocal contracts through an attorney-in-fact.

The Company is owned by its member subscribers which consist of 30 not-for-profit acute care hospitals located in North Dakota. The Company provides occurrence general liability, claims-made hospital medical malpractice coverage, and claims-made physician medical malpractice coverage within the state of North Dakota. Policies are issued on an assessable basis to a maximum additional assessment of fifty percent of premiums to cover losses and operating expenses of the exchange.

MANAGEMENT AND CONTROL

Directors

The Bylaws provide that the number of directors of the reciprocal shall be 12 who shall hold office until the next annual meeting of member subscribers and until their successor shall have been elected and qualified.

The following directors were serving as of the date of this examination:

Name and Address	Business Affiliation
Lowell Herfindal	Tioga Medical Center
Dan Howell	Sakakawea Medical Center
Larry Feichert	Northwood Deaconess Health Center
Richard Tschider	St. Alexius Medical Center
Steve Feltman	Unity Medical Center
Daryl Wilkins	Cavalier County Memorial Hospital
Richard Albrecht	Linton Hospital
Richard Hall	Jamestown Hospital
Gary Kenner	UniMed
Rosemary Jacobson	United Hospital
Keith Korman	St. Andrew’s Hospital

It was noted that Company is not in compliance with Article III, Section 1 of its Bylaws, which requires the number of directors to be 12.

It is recommended that the Company comply with Article III, Section 1 of its Bylaws.

Officers

The Bylaws provide that the officers of the Company shall be a President, a Vice President, and a Secretary.

Officers serving as of the date of this examination were as follows:

David Vaaler	President
Clair Thompson	Vice President
Kathyrn Waslien	Secretary

Committees

During each of the years under review, the Board of Directors designated committees to assist the directors in various aspects of Company operations. The committees and their respective members at December 31, 1996, were as follows:

Finance Committee	Randy Pederson Gary Miller Dwight Thompson Aaron Alton
Claims Committee	Rosemary Jacobson Chris Austin Bert Speidel Pam Tyler Cindy Siders Jeff Johnson Yvonne Pederson Curt Fogel
Executive Committee	Lowell Herfindal Rosemary Jacobson

The Executive Committee has not held any meetings during the period under review and is dormant. The Company is not in conformity with Article IV, Section 1, of its Bylaws which states the Executive Committee shall consist of three or more directors.

Attorney-in-Fact

The affairs of the Company are under the direction of the Attorney-in-Fact as authorized by the Board of Directors and approved by the subscribers. As of December 31, 1996, the Attorney-in-Fact is Risk Management Services, Inc.

Conflict Of Interest

The Company maintains a formal conflict of interest policy and an established procedure for disclosure of any material interest or affiliations that might tend to influence a board member, officer, or employee in the performance of their duties. Conflict of interest statements executed during the period under examination were reviewed with no material conflicts noted.

Corporate Records

Article VIII of the Bylaws was amended during the period under examination but was not submitted to the Insurance Department.

It is recommended that the Company file any amendments to its Bylaws with the North Dakota Insurance Department.

MANAGEMENT AGREEMENT

The Company and the Attorney-in-Fact have entered into a management agreement effective July 1, 1990, whereby the Attorney-in-Fact has the responsibility for all of the underwriting, claim administration, policy administration, accounting, and managerial responsibility of the business of the Company.

TERRITORY AND PLAN OF OPERATION

The Company is licensed only in the State of North Dakota. The Company writes personal injury liability, property damage liability, and medical malpractice coverage for members and staff of the North Dakota Hospital Association and other medical facilities or individuals, partnerships, or corporations allowed by law.

Each insurance policy issued by the Company shall be assessable to a maximum of 50 percent of the annual premium for said policy. Based on the agreement, each subscriber's liability is limited to the amount of the premiums paid by the subscriber, the accessibility of its policy, and the rights and interests of the subscribers in and to the assets and accounts of the exchange.

REINSURANCE

At December 31, 1996, the Company had the following reinsurance treaty in force:

Type:	Per Risk Excess of Loss or Pro Rata
Reinsurer:	PHICO Insurance Company
Scope:	Personal injury and property damage liability (occurrence coverage), institutional professional and physicians professional liability (claims-made coverage)
Coverage:	50% of the first $200,000 of each loss, 80% of 800,000 each loss in excess of the first $200,000. All net losses in excess of an annual total of $1,000,000.
Commissions:	None
Effective Date:	January 1, 1996
Termination:	January 1, 1997

The foregoing reinsurer is licensed in the State of North Dakota.

ACCOUNTS AND RECORDS

The Examiner obtained a trial balance for 1996 and traced it to the annual statement with no exceptions noted.

FINANCIAL STATEMENTS

The following pages present the Company's Statement of Assets, Liabilities, Surplus, and Other Funds as of December 31, 1996, as determined by this examination. The balance sheet is followed by the following statements and reconciliations:

Summary of Operations For the Year Ended December 31, 1996

Capital and Surplus Account For the Year 1996

Reconciliation of Capital and Surplus Account, January 1, 1991, through December 31, 1996

Health Facilities Insurance Exchange
Statement of Assets, Liabilities, Surplus, and Other Funds
as of December 31, 1996

	Ledger Assets	Nonledger Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$1,524,856			$1,524,856
Cash on Deposit	8,097			8,097
Short-Term Investments	238,719			238,719
Premiums in Course of Collection	6,699		$6,593	106
Reinsurance Recoverable on Loss And Loss Adjustment Expense Payments	9,500			9,500
Totals	$1,787,871		$6,593	$1,781,278

Liabilities, Surplus, and Other Funds

Losses	$1,251,809
Taxes, Licenses, and Fees	3,322
Excess of Statutory Reserves over Statement Reserves	145,000
Claims Payable to PHICO Insurance Company	15,000
Total Liabilities	$1,415,131
Subscriber Capital Accounts	$ 109,045
Subscriber Savings Accounts	459,693
Unassigned Surplus	(202,591)
Surplus as Regards Policyholders	$ 366,147
Total Liabilities, Surplus, and Other Funds	$1,781,278

Health Facilities Insurance Exchange
Summary of Operations
for the Year Ended December 31, 1996

Underwriting Income

Premiums Earned		$674,657
Deductions:		
Losses Incurred	$639,487	
Other Underwriting Expenses Incurred	27,216	
Total Underwriting Deductions		666,703
Net Underwriting Gain or (Loss)		$ 7,954

Investment Income

Net Investment Income Earned	$91,589	
Net Realized Capital Gains or (Losses)	(21,664)	
Net Investment Gain or (Loss)		$ 69,925
Net Income Before Federal Income Taxes		77,879
Federal Income Taxes Incurred		(25,232)
Net Income		$103,111

Capital and Surplus Account for the Year 1996

Capital and Surplus, December 31, Previous Year		$403,303
Net Income	$103,111	
Net Unrealized Capital Gains	11,808	
Change in Excess of Statutory Reserves Over Statement Reserves	(145,000)	
Transferred from Capital	(7,075)	
Change in Policyholder Surplus for the Year		(37,156)
Capital and Surplus, December 31, Current Year		$366,147

Health Facilities Insurance Exchange
Reconciliation of Capital and Surplus Account
January 1, 1991, Through December 31, 1996

	1991	1992	1993	1994	1995	1996
Capital and Surplus, December 31, Previous Year	$(31,677)	$(52,480)	$(54,223)	$ 57,453	$(167,047)	$403,303
Net Income	(20,803)	(1,743)	111,676	(136,864)	528,152	103,111
Net Unrealized Capital Gains or (Losses)				(86,225)	74,417	11,808
Change in Non-Admitted Assets				(1,411)	1,411	
Change in Excess of Statutory Reserves Over Statement Reserves						(145,000)
Paid in Surplus					(33,630)	
Transferred from Capital						(7,075)
Unaccounted Difference						
Net Change in Capital and Surplus for the Year	(20,803)	(1,743)	111,676	(224,500)	570,350	(37,156)
Capital and Surplus, December 31, Current Year	(52,480)	(54,223)	57,453	(167,047)	403,303	366,147

COMMENTS TO THE FINANCIAL STATEMENTS

Financial statement balances at December 31, 1996, are commented upon only if financial changes, recommendations, or special explanations are considered necessary.

Bonds **$1,524,856**

The admitted value of bonds was determined by this examination to be $1,524,856, the same amount as reported by the Company in its 1996 Annual Statement. The bonds are held by the First National Bank of North Dakota under a custodial agreement. All of the bonds are U.S. Treasury Notes.

The custodial agreement does not contain the following safeguards as required by the NAIC Examiners Handbook:

1. Custodian will indemnify the insurance company for any loss caused by negligence or dishonesty of the bank or trust company while securities are in its custody; and

2. The securities will be promptly replaced if there is a loss for which the bank or trust company is obligated to indemnify the insurance company.

It is recommended that the Company amend its custodial agreement to include the safeguards required by the NAIC.

The *NAIC's Accounting Practices and Procedures Manual for Property Casualty Companies* require insurers to value bonds at cost and amortize them under the valuation standards of the NAIC. This examination noted that the Company was not amortizing the discount on the bonds. **It is recommended that the Company amortize the discount on bonds.**

Interest due on bonds represents certain amounts of income which are legally owed to the Company as of the statement date but have not yet been received. This examination noted that the Company was not accruing interest due on the bonds. **It is recommended that the Company accrue for interest on the bonds.**

The admitted value of bonds owned by the Company at December 31, 1996, represents 85 percent of the Company's admitted assets. All of the Company's bonds were rated as investment grade. The book value, market value, cost, and par value of the bond portfolio are as follows at December 31, 1996:

Statement Value	NAIC Market Value	Actual Cost	Par Value
$1,524,856	$1,536,718	$1,524,856	$1,545,000

<u>Premiums in Course of Collection</u> **$106**

This asset has been decreased by $6,593 from $6,699 to $106. The Company treated premiums over 90 days past due as an admitted asset. The *NAIC's Accounting Practices and Procedures Manual for Property & Casualty Companies* states that premiums over 90 days past due are a nonadmitted asset. **It is recommended that premiums over 90 days past due be classified as a nonadmitted asset.**

CONCLUSION

The financial condition of the Company, as of December 31, 1996, as determined by this examination is summarized as follows:

Admitted Assets		$ 1,781,278
Total Liabilities	$ 1,415,131	
Surplus as Regards Policyholders	366,147	
Liabilities, Surplus, and Other Funds		$ 1,781,278

The courteous cooperation extended by the officers of the Company during the course of the examination is gratefully acknowledged.

Respectfully submitted,

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Diane Shervey, AFE
North Dakota Insurance Department

COMMENTS AND RECOMMENDATIONS

Page 3 — It is recommended that the Company comply with Article III, Section 1 of its Bylaws.

Page 4 — It is recommended that the Company file any amendments to its Bylaws with the North Dakota Insurance Department.

Page 9 — It is recommended that the Company amend its custodial agreement to include the safeguards required by the NAIC, as follows:

1. Custodian will indemnify the insurance company for any loss caused by negligence or dishonesty of the bank or trust company while securities are in its custody; and

2. The securities will be promptly replaced if there is a loss for which the bank or trust company is obligated to indemnify the insurance company.

It is recommended that the Company amortize the discount on bonds and accrue for interest due.

Page 10 — It is recommended that premiums over 90 days past due be classified as a nonadmitted asset.

SUBSEQUENT EVENTS

In 1997, the member subscribers formed a separate risk purchase group under N.D.C.C. Chapter 26.1-46 and purchased their professional and general liability insurance through a newly formed limited liability company. Therefore, at January 1, 1997, the company is in an inactive state.